

separations, lack of documentation, and other apparent errors. In attachment B, we present the information in the record that describes the impact of these apparent violations on the BellSouth carriers' interstate revenue requirements for the fifteen-month audit period.

A. Cash Working Capital

2. We find that BellSouth's calculation of cash working capital allowances may have violated Commission requirements. Specifically, BellSouth's development of those allowances apparently violated Sections 65.800 and 65.820(d) and (e) of the Commission's rules, which instruct carriers on how to calculate the interstate rate base.¹ As a result of its cash working capital calculations, BellSouth reported incorrect information to NECA in apparent violation of Section 69.605 of the rules² and to the Commission in apparent violation of Section 65.600 of the rules.³ Finally, to the extent this information has been reported in the Commission's automated database, Automated Reporting Management Information System (ARMIS), BellSouth also appears to have violated Section 43.21 of the rules, which requires that data filed in ARMIS be accurate, complete, and responsive, and certified as such by a senior carrier officer.⁴

3. The elements of lead-lag studies to calculate cash working capital were set forth in Docket No. 19129⁵ and reaffirmed in Docket No. 86-497.⁶ Lead-lag studies measure cash inflows and outflows in relation to the time service is rendered. Revenue and expense items that are received or paid before a service is rendered are considered "lead" items, and revenue and expense items that are received or paid after service is rendered are considered "lag" items.⁷ Lead-lag studies determine the number of days between receipt of revenues and payment of expenses. The net number of revenue lag days is then multiplied by the average daily cash expenses to determine cash working capital.⁸ A positive net lag results in a positive cash working capital allowance, which increases the rate base; a negative one results in a negative allowance, which reduces the rate base.⁹ In previous orders and proceedings, we have set forth the specific criteria for the inclusion and exclu-

sion of various items in cash working capital calculations, but the general rule is that the net lead or lag is applied to the average daily cash expenses. The specifics of BellSouth's apparent violation are discussed below.

4. *Apparent Violation No. 1:* In calculating cash working capital allowances, carriers are allowed to add minimum bank balances to the results obtained from lead-lag studies. The independent auditor found that BellSouth substituted average daily cash balances for minimum bank balances in its cash working capital computations.¹⁰ This practice resulted in a \$4,836,000 overstatement of BellSouth's interstate revenue requirements for January 1988 through March 1989, according to the independent auditor.¹¹

5. BellSouth argues that its use of average daily cash balances is proper. To support its position, BellSouth cites American Telephone and Telegraph Company (AT&T) and Bell Communication Research, Inc. (Bellcore)¹² company documents that instruct carriers to use average daily bank balances when computing cash working capital. BellSouth contends that these documents make clear that the Commission permits the use of average daily cash balances in computing cash working capital.¹³

6. Although BellSouth admits that the 86-497 *Reconsideration Order*¹⁴ stated that the Commission did not intend to depart from the established policy of including minimum bank balances in cash working capital, BellSouth maintains that the Commission had previously permitted more than minimum bank balances to be included in cash working capital. In this regard, BellSouth points out that in Docket No. 19129, the Commission required AT&T to submit a program of cash management to "minimize cash requirements for the daily operation of the business."¹⁵ BellSouth maintains that requirement described a program that was not strictly limited to compensatory or minimum bank balances. BellSouth also contends that it has consistently included average daily cash balances as the minimum cash balance in its cash working capital determination.

¹ 47 C.F.R. §§65.800, 65.820(d)-(e). These rules require carriers, like the BellSouth carriers, to calculate the cash working capital component of their interstate rate base either by performing a lead-lag study of interstate revenue and expense items or by applying a specified formula. BellSouth elected to perform lead-lag studies.

² 47 C.F.R. §69.605.

³ 47 C.F.R. §65.600. In these rate of return reports to the Commission, BellSouth is required to "provide full and specific answers to all questions propounded and information requested..." 47 C.F.R. §65.600(b), (d)(1).

⁴ 47 C.F.R. §43.21(a).

⁵ American Telephone & Telegraph Co., Docket No. 19129, *Phase II Final Decision*, 64 FCC 2d 1, 72-73, para. 187 (1977) (19129 *Phase II Final Decision*), *aff'd Phase II Initial Decision*, 64 FCC 2d 131 (1976) (19129 *Phase II Initial Decision*).

⁶ Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, CC Docket No. 86-497, *Report and Order*, 3 FCC Rcd 269 (1987) (86-497 *Order*), *recon.*, 4 FCC Rcd 1697 (1989) (86-497 *Reconsideration Order*), *remanded sub nom. Illinois Bell Telephone Co. v. FCC*, 911 F.2d 776 (D.C. Cir. 1990) (*Illinois Bell I*), *on remand*, 7 FCC Rcd 296 (1991) (84-497 *Decision on Remand*), *affirmed sub nom. Illinois Bell Telephone Co. v. FCC*, 908 F.2d 1254 (D.C. Cir. 1993) (*Illinois Bell II*).

⁷ Related terms include "expense lag" (the average net lag of all of a carrier's cash expenses), "revenue lag" (the average net lag of a carrier's revenues), and "net lag" (the net of a carrier's expense lag and revenue lag).

⁸ 86-497 *Decision on Remand*, 7 FCC Rcd at 297, para. 9.

⁹ Annual 1990 Access Tariff Filings, *Memorandum Opinion and Order*, 5 FCC Rcd 4177, 4219 (1990).

¹⁰ *Adjustments Report* at 41.

¹¹ Letter from Bruce Baldwin, President, National Exchange Carrier Association, Inc., to Mr. Gerald P. Vaughan, Deputy Chief, Operations, Common Carrier Bureau, at BellSouth Attachment (October 12, 1992) (*October 12 Letter*).

¹² Bellcore is a corporation that was created at the 1984 divestiture of AT&T to provide research, engineering, and technical support services to its owners, the Regional Bell Holding Companies, and their affiliates, the Bell Operating Companies.

¹³ *Adjustments Report* at 42-43, citing Comptrollers Letter M-318, Outline of Procedures for Preparing Cash Working Capital Lag Studies (AT&T Sept. 2, 1977); Section DR90.25 (AT&T Jan. 1983); Section SS10.30 (Bellcore June 1984); & Section 550, Issue 2 (Bellcore Sept. 1988).

¹⁴ 4 FCC Rcd at 1699, para. 22.

¹⁵ *Adjustments Report* at 44, quoting, *Phase II Final Decision*, 64 FCC 2d at 76, para. 195 & *Phase II Initial Decision*, 64 FCC 2d at 410, para. 908.

BellSouth states that the Commission has approved this practice in every AT&T rate filing since 1978 and every BellSouth rate filing since 1984.¹⁶

7. We do not find BellSouth's arguments persuasive because the Commission has long held that only minimum bank balances, and not average daily bank balances, should be included in the cash working capital computation. Company documents that interpret Commission policy or rules do not substitute for Commission policy or rules. Additionally, the Commission's request in Docket 19129 for information regarding AT&T's cash management practices cannot reasonably be interpreted to mean that average daily bank balances were to be included in cash working capital. That request was initiated by the Administrative Law Judge (ALJ), who made clear that minimum bank balances, rather than actual cash balances, were to be included in cash working capital.¹⁷ In requiring AT&T to submit a cash management program, the ALJ noted that AT&T had "presented no evidence on the basis of which the Commission can rely to persuade [it] that the cash balances [AT&T] claims in its rate base are required in the rendition of service."¹⁸ Indeed, in affirming the ALJ's requirement, the Commission specifically excluded "General Department demand deposits and petty cash working funds" from cash working capital.¹⁹

8. Lastly, BellSouth cites no Commission order or other document approving the inclusion of average daily bank balances in cash working capital. If we allowed BellSouth's or AT&T's rates to take effect despite such inclusion, it was only because those carriers' rate filings did not disclose their specific practices. BellSouth's method of calculating its cash working capital allowances apparently violates our requirements.

B. Jurisdictional Separations

9. *Apparent Violation No. 2.* Effective January 1, 1988, the Commission adopted Section 36.142(a) of the rules,²⁰ which requires certain carriers, including the BellSouth carriers, to apportion all information origination-termination (IOT) equipment costs,²¹ other than those for coinless pay telephone equipment and detariffed customer premises equipment, between the federal and state jurisdictions using the transitional subscriber plant factor.²²

¹⁶ *Adjustments Report* at 44.

¹⁷ The ALJ emphasized that:

working capital is intended to provide only for the current day-to-day needs of the business and not for any of the capital requirement. Second, working capital is the amount of dollars that are necessary to meet current needs, not the amount of dollars that a public utility would like to have on hand or might actually have on hand.

Docket 19129 Phase II Initial Decision, 64 FCC 2d at 403, para. 401.

¹⁸ *Id.* at 409, para. 907.

¹⁹ *Docket 19129 Phase II Final Decision*, 64 FCC 2d at 76 n.141. The General Department of AT&T provided the BOCs with centralized staff services. *Docket 19129 Phase II Initial Decision*, 64 FCC 2d at 144, para. 30.

²⁰ 47 C.F.R. 43.6142(a).

²¹ IOT equipment consists of electronic devices and supporting equipment used to originate and terminate telecommunication messages at the end users' premises. See 47 C.F.R. Part 34, Appendix B, includes station apparatus such as telephone and

Section 69.303(b) of the Commission's rules, in turn, requires LECs to apportion the interstate portion of that investment between the special access and CL elements "on the basis of the relative number of equivalent lines in use."²³

10. The independent auditor found that BellSouth directly assigned IOT investment to special access in its 1988 annual access tariff filing. BellSouth argues that Western Union challenged this direct assignment in comments on that BellSouth filing, that BellSouth defended the direct assignment in its response to Western Union, and that the Commission allowed BellSouth special access rates to go into effect. The independent auditor noted the findings in the Commission staff audit of the CL pool that had prompted the Commission to order an independent audit.²⁴ In its audit report issued in November 1990,²⁵ the Commission staff concluded that direct assignment of IOT investment is inconsistent with Commission rules.²⁶ Although the independent auditor indicated that this direct assignment understated BellSouth's CL and total interstate revenue requirements for 1988 by \$13.3 million,²⁷ we believe that it instead shifted IOT costs for 1988 from CL to interstate special access, as shown in Attachment B.

11. BellSouth argues that the independent auditor's statements confirm that its treatment of IOT costs was completely appropriate and the only proper course it could have taken. BellSouth states that its 1988 tariff filing clearly displayed BellSouth's direct assignment of IOT costs to special access, that the Commission was clearly aware of its action, and that the Commission allowed its special access rates as well as NECA's CL rates to become effective with the allocation of IOT costs to special access. BellSouth argues that had it changed its allocation of IOT costs during this period, changes in both CL and special access rates would have been required to avoid a revenue-cost mismatch. BellSouth states further that the Commission staff did not indicate that the direct assignment of IOT costs was incorrect until it issued its audit report of the CL pool in November 1990, some two years after the allocation in question was used to establish rates. BellSouth states that if the Commission believes that this November 1990 interpretation is applicable to BellSouth, then the Commis-

miscellaneous equipment, teletypewriter equipment, small private branch exchanges, and radio equipment (excluding mobile) installed for the end users' use. It also includes embedded customer premise wiring, large private branch exchanges, public telephone terminal equipment, and other terminal equipment. See 47 C.F.R. 43.6141(a).

²² The subscriber plant factor was formerly used to allocate interstate operations certain investment in plant, subscriber lines, station equipment, and a portion of central office switching used for message telephone service. Each company's subscriber plant factor was frozen at its 1981 average level and then phased into a nationwide basic allocation factor of 15% over eight years beginning January 1, 1988. Thus, the subscriber plant factor became known as the "transitional subscriber plant factor" during the phase-in period. 47 C.F.R. 43.6154(c)(1).

²³ 47 C.F.R. 69.303(b).

²⁴ See *Order to Show Cause*, *supra* at para. 3.

²⁵ *Audit Report: Review of Adjustments to the NECA Common Line Pool* (Audits Branch, Oct. 26, 1990).

²⁶ *Adjustments Report* at 39.

²⁷ *October 12 Letter to BellS. and Attachment*.

sion must consider reopening the CL pool for 1988 to allow BellSouth to submit additional IOT expenses for recovery.²⁸

12. BellSouth, in effect, presents two arguments to justify its direct assignment of IOT costs. First, BellSouth argues that the interpretation of the rules set forth in the Commission staff's November 1990 audit report is incorrect. Second, BellSouth maintains that even if correct, that interpretation should not be applied to BellSouth because the 1988 Access Tariff Order²⁹ had allowed BellSouth's 1988 special access rate to go into effect even though it reflected a direct assignment of IOT costs to special access. We address these arguments in turn.

13. BellSouth's argument that the interpretation in the Commission staff's November 1990 audit report is incorrect apparently reflects BellSouth's belief that Part 36, and in particular Section 36.1(c), of our rules permit the direct assignment of IOT costs to special access.³⁰ Our Part 36 rules, however, prescribe the procedures telecommunications companies must use in apportioning their costs and revenues between the state and interstate jurisdictions. Sections 36.1 and 36.2 outline the separations procedures and the principles that underlie them.³¹ These sections state that jurisdictional separations are to be made using either direct assignment or a particular allocator.³² These general statements do not grant carriers discretion, but only introduce the Part 36 rules that explain when and how direct assignment or an allocator is to be used. If the general introductory statements had been meant as dispositive, there would have been no need for specific language in the rules that follow, to allow or encourage the use of direct assignment.³³ Sections 36.1(c) and 36.2(a)(1) do not create a general invitation to use direct assignment as the filing carrier chooses.

14. BellSouth also maintains that the Commission implicitly accepted direct assignment of IOT costs to special access in amending Part 69 in 1987 because the Commission intended Part 69 to conform with Part 36.³⁴ We find no support for this argument in the language of Part 69. On the contrary, Section 69.303(b) of the Commission's rules states unequivocally that LECs are to apportion "all" IOT investment other than that in public telephones and

appurtenances between the special access and CL elements "on the basis of the relative number of equivalent lines in use."³⁵ There is no language in Section 69.303 or in other portions of Part 69 that states or implies that direct assignment is an alternative to this allocation method.

15. As the independent auditor observed, BellSouth and NECA both directly assigned IOT costs to special access in their 1988 access tariff filings, and the Common Carrier Bureau (Bureau) allowed BellSouth's special access and NECA's CL rates to take effect without correcting these improper direct assignments.³⁶ In allowing those rates to take effect, however, the Bureau made no finding as to their underlying lawfulness.³⁷ In these circumstances, we reject BellSouth's apparent position that this Bureau action absolved BellSouth of its responsibility to report its IOT costs to NECA in accordance with Sections 36.142(a) and 69.303(b). BellSouth should have been aware both from the language of the rule and from communications with NECA³⁸ that its direct assignment of IOT was inconsistent with the Commission's rules. Nevertheless, BellSouth continued to assign its IOT costs directly to special access during 1988 and attempted no retroactive adjustment to correct that improper direct assignment. Those actions apparently violated Sections 36.142(a) and 69.303(b) of our rules.

16. *Apparent Violation No. 3:* Section 36.153 of the Commission's rules prescribes the methods for assigning cable and wire facilities (C&WF) costs to four specific separations categories.³⁹ The independent auditor found that in Alabama, Louisiana, and Mississippi, BellSouth used an incorrect basic study factor⁴⁰ that decreased the C&WF costs assigned to category 2, Gwideband and exchange trunk C&WF, for private local service. The independent auditor stated that this incorrect factor shifted costs to category 1, exchange line C&WF excluding wideband, for which the costs are directly assigned to the CL rate element.⁴¹ The independent auditor stated further that this

²⁸ *Adjustments Report* at 39-40.

²⁹ Annual 1988 Access Tariff Filings, *Memorandum, Opinion and Order*, 3 FCC Rcd 1281, 1295 (Com. Car. Bur. 1987) (1988 Access Tariff Order).

³⁰ *Id.* at 39, citing BellSouth Reply in 1988 Access Tariff Proceeding.

³¹ 47 C.F.R. §§36.1, 36.2.

³² 47 C.F.R. §§36.1(c), 36.2(a)(1).

³³ Compare 47 C.F.R. §36.157(a)(1) (certain cable and wire facilities costs to be apportioned) with 47 C.F.R. §36.157(a)(2) (other cable and wire facilities costs to be directly assigned).

³⁴ *Adjustments Report* at 39, citing BellSouth Reply in 1988 Access Tariff Proceeding.

³⁵ 47 C.F.R. §69.303(b).

³⁶ See Annual 1988 Access Tariff Filings, *Memorandum Opinion and Order*, 3 FCC Rcd 1281, 1295, paras. 114 & 116 (Com. Car. Bur. 1987) (allowing BellSouth's 1988 special access tariff to take effect notwithstanding Western Union's argument regarding the over allocation of IOT investment to special access).

³⁷ See *id.* The Bureau did not explain why it allowed BellSouth's special access tariff to take effect, while suspending the special access tariffs of other carriers.

³⁸ In June 1988, NECA's Separations Advisory Group informed

BellSouth that the Commission staff had concluded that BellSouth's IOT methodology was unacceptable. Response of the NYNEX Telephone Companies, New England Telephone & Telegraph Co. & New York Telephone Co., *Apparent Violations of the Commission's Rules*, Affidavit of Alfred Boschulte at Attachment A (filed Dec. 10, 1990). While informal advice of Commission staff is not definitive, *Maliken FM Assoc. v. FCC*, 935 F.2d 1313, 1319 (D.C. Cir. 1991), this communication should have alerted BellSouth that the Bureau, by allowing its 1988 special access tariff to take effect, had not intended to approve BellSouth's IOT methodology.

³⁹ Section 36.152 of the Commission's rules, 47 C.F.R. §36.152, lists these categories.

⁴⁰ Basic study factors are ratios such as minute miles per message or book costs per mile of cable that are applied to monthly volume counts, quantity counts, investment, expenses, or other data to assign costs in the separations process. Some basic study factors are used to assign costs to separations categories; other basic study factors are used to apportion plant investment, expenses, and taxes between the state and interstate jurisdictions. To develop basic study factors, the LECs periodically perform studies in which they analyze costs and other data for a specific period of time.

⁴¹ *Adjustments Report* at 46-47.

error overstated BellSouth's interstate revenue requirements for January 1988 through March 1989 by \$1,025,000.⁴²

17. BellSouth admits that the basic study factor was wrong and explains that a worksheet error produced it.⁴³ We find that BellSouth's use of this incorrect basic study factor apparently violated Section 36.153.

C. Lack of Documentation and Other Apparent Errors

18. *Apparent Violation No. 4:* One element of a reliable accounting system is maintaining records that support accounting entries. Section 220(c) of the Communications Act recognizes this by authorizing the Commission to have access to and the right of inspection and examination of "all accounts, records, and memoranda, including all documents, papers, and correspondence . . . kept or required to be kept" by the BellSouth carriers.⁴⁴ Section 220(c) also places "[t]he burden of proof to justify every accounting entry questioned by the Commission . . . on the person making, authorizing, or requiring such entry."⁴⁵ In addition, Section 32.12(b) of our rules requires the BellSouth carriers to keep their accounting records "with sufficient particularity to show fully the facts pertaining to all accounting entries" and to file "[t]he detail records in such manner as to be readily accessible for examination" by Commission representatives.⁴⁶

19. The independent auditor found twenty-two instances where revenue, cost, basic study or tax adjustments, each involving in excess of \$100,000 in costs or revenues, were unsupported by adequate documentation. South Central Bell in Alabama could not provide adequate documentation to support three adjustments

South Central Bell in Kentucky could not provide support documentation for one adjustment

South Central Bell in Louisiana could not provide support documentation for two adjustments

South Central Bell in Mississippi could not provide support documentation for two adjustments

South Central Bell in Tennessee was unable to provide support documentation for two adjustments

Southern Bell in Florida could not provide support documentation for two adjustments

Southern Bell in Georgia could not provide support documentation for four adjustments

Southern Bell in North Carolina could not provide support documentation for two adjustments

Southern Bell in South Carolina could not provide support documentation for four adjustments.⁴⁷

20. In all twenty-two cases, BellSouth admits that it could not locate the supporting documentation.⁴⁸ We tentatively find that BellSouth's admitted documentation failures would support a conclusion that BellSouth fails to keep its accounts, records, and memoranda as prescribed by the Commission.

21. *Apparent Violation No. 5:* The 800 Readyline service was an AT&T 800 service that terminated over the customer's local exchange service line rather than over a dedicated WATS-type line. The independent auditor found that in Alabama, when reporting an 800 Readyline accrual adjustment to NECA, BellSouth reported an increase in revenues instead of the decrease which actually occurred. The error resulted in BellSouth's overstating its CL revenues for September 1988 by \$338,000.⁴⁹ BellSouth admits this error and explains that an input of \$169,000 was inadvertently made with the wrong sign resulting in the \$338,000 overstatement of revenue.⁵⁰ We find that in this instance, BellSouth's internal accounting controls were apparently deficient.

22. *Apparent Violation No. 6:* The independent auditor found that South Central Bell included presubscription revenues for the predesignation of interexchange carriers (IXCs) by end users in Account 5081. End user revenue, in apparent violation of Section 32.5081 of the Commission's rules⁵¹ This overstated BellSouth's CL revenues and understated its traffic sensitive revenues for January 1988 through March 1989 by \$999,000.⁵²

23. We quote Section 32.5081 in its entirety:

§32.5081 End user revenue. This account shall contain the federally tariffed monthly flat rate charge assessed upon end users.⁵³

We find no support here for BellSouth's inclusion of these revenues in Account 5081, and its eventual assignment of these revenues to the CL pool. Under the Commission's rules, Account 5081 contains revenue generated by the federally tariffed flat monthly rate charge assessed upon end users. Account 5081 does not include additional amounts, like presubscription revenues, even though they are tariffed amounts charged to end users. Presubscription revenues pertain to the switched message toll service, and carriers must include them in Account 5082, Switched access revenue⁵⁴ which is assigned to the traffic sensitive element as miscellaneous service revenues. Thus, apparently, BellSouth not only reported these revenues to the wrong NECA pool, but also recorded them in the wrong account.

24. The above errors suggest that BellSouth's internal controls apparently failed to function properly in multiple instances. As a result of such errors, it may be necessary to require adjustments to BellSouth's price cap indexes and

⁴² October 12 Letter, at BellSouth Attachment.

⁴³ Adjustments Report at 47.

⁴⁴ 47 U.S.C. §220(c).

⁴⁵ *Id.*

⁴⁶ 47 C.F.R. §32.12(b).

⁴⁷ Adjustments Report at 45-46.

⁴⁸ *Id.* at 46.

⁴⁹ Adjustments Report at 47.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² October 12 Letter, at BellSouth Attachment.

⁵³ 47 C.F.R. §32.5081.

⁵⁴ 47 C.F.R. §32.5082.

take other remedial action depending upon our review of the additional information we have directed BellSouth to submit.

Attachment B

BELLSOUTH - Summary of Apparent Violations

INTERSTATE REVENUE REQUIREMENT
OVERSTATEMENT FOR THE AUDIT PERIOD (See Note)
(\$000)

COMMISSION FINDING	CARRIER	TOTAL	COMMON LINE	OTHER INTERSTATE ACCESS ELEMENTS
1. Included amounts in excess of minimum bank balances in computing CWC.	BellSouth	4,836	2,661	2,175
2. Used direct assignment of IO/T where not allowed.	BellSouth	0	(13,300)	13,300
3. Used incorrect basic study for C&WF Category 2.	BellSouth	1,025	854	171
4. Numerous unsupported retroactive adjustments.	BellSouth		Unknown	
5. Errors in reporting 800 readyline service revenues.	BellSouth	(338)	(338)	0
6. Erroneously reported PICC revenues to common line.	BellSouth	0	(999)	999

Note: Overstated expenses are indicated by positive amounts.
Understated expenses are indicated by negative (parentheses) amounts.
Overstated revenues are indicated by negative (parentheses) amounts.
Understated revenues are indicated by positive amounts.

Attachment 5

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
The BellSouth Telephone) AAD No. 93-148
Operating Companies)
)

CONSENT DECREE ORDER

Adopted: October 15, 1996

Released: November 1, 1996

By the Commission:

1. At the direction of the Commission, the National Exchange Carrier Association, Inc. ("NECA") hired Ernst and Young to conduct an independent audit of carrier-reported adjustments to the common line revenue pool for 1988 and the first quarter of 1989. On December 9, 1991, NECA submitted to the Commission Ernst and Young's report ("Adjustments Report").¹

2. The independent auditor reported numerous apparent violations of the Commission's rules committed by the Bell Operating Companies, including BellSouth Telecommunications, Inc. ("BellSouth").² These apparent violations generally involve failures to keep accounts, memoranda and records in the manner prescribed by the Commission.

3. On March 3, 1995, the Commission released an *Order to Show Cause*³ directing BellSouth to show cause why the Commission should not: (1) issue a Notice of Apparent Liability for Forfeiture for apparent violation of Section 220(d) of the Communications Act of 1934, as amended;⁴ (2) require BellSouth to adjust its price cap indexes; and (3) require BellSouth to improve its internal processes to bring them into compliance with Commission rules

¹ Letter to Robert A. McAnton from Donna Searcy, 8 FCC Rcd 1315 (1993).

² On January 1, 1992, the former BellSouth operating companies, Southern Bell Telephone and Telegraph Co. and South Central Bell Telephone Co., were merged into BellSouth Telecommunications, Inc.

³ BellSouth Telecommunications, Inc., *Order to Show Cause*, 10 FCC Rcd 5637 (1995) (*Order to Show Cause*).

⁴ 47 U.S.C. § 220(d).

and orders.

4. On May 2, 1995, BellSouth responded to the Commission's *Order to Show Cause* and contested and denied each of the NECA audit report findings listed in the Commission's Order. By public notice dated June 20, 1995, the Common Carrier Bureau invited public comment on BellSouth's response.⁵ Only MCI Telecommunications Corporation filed comments, and BellSouth replied on September 11, 1995.

5. This Commission and BellSouth have reached an agreement with respect to these audit findings. The terms and conditions of this agreement are contained in the attached Consent Decree.

6. We have reviewed the terms of the Consent Decree and evaluated the circumstances of the case. We believe the public interest would be served by approving the Consent Decree, the terms of which are incorporated herein by reference.

7. Accordingly, IT IS ORDERED, pursuant to Sections 4(i) and 4(j) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and (j), that the Consent Decree, incorporated by reference herein and attached to this Order, IS HEREBY ADOPTED, and the Secretary shall sign such Consent Decree on behalf of the Commission.

8. IT IS FURTHER ORDERED that this Order is effective upon execution of the Consent Decree by all parties to the Agreement.

9. IT IS FURTHER ORDERED that proceedings under the March 3, 1995 *Order to Show Cause*, 10 FCC Rcd 5637, ARE HEREBY TERMINATED.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

⁵ Commission Sets Pleading Schedule In Show Cause Proceedings, *Public Notice*, 10 FCC Rcd 10939 (1995).

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
The BellSouth Telephone) AAD No. 93-148
Operating Companies)
)

CONSENT DECREE

1. This is a Consent Decree entered into by the Federal Communications Commission ("Commission") and BellSouth Telecommunications, Inc. ("BellSouth") (collectively referred to herein as the "Parties").¹

2. The common line revenue pool is administered by the National Exchange Carrier Association, Inc. ("NECA") and allows incumbent local exchange carriers ("LECs") to participate in a tariff filed by NECA that establishes uniform access rates on a nation-wide basis for all participants. Monthly distributions from the pool are computed using monthly revenue, expense and investment figures reported by the participating LECs. Initially the figures are only estimates, but in later months the incumbent LECs adjust them to actual monthly figures. At the direction of the Commission, NECA hired Ernst and Young to conduct an independent audit of carrier-reported adjustments to the common line revenue pool for 1988 and the first quarter of 1989. The Ernst and Young audit report ("Adjustments Report") included numerous audit findings against the Bell Operating Companies, including BellSouth, concerning apparent rule violations and misconduct. These findings generally involve failures to keep accounts, memoranda and records in the manner prescribed by the Commission.

3. On March 3, 1995, the Commission released an *Order to Show Cause* directing BellSouth to respond to certain of the findings in the Adjustments Report.² On May 2, 1995, BellSouth responded to the Commission's *Order to Show Cause* and contested and denied each of the Adjustments Report findings listed in the Commission's Order. By public notice dated June 20, 1995, the Common Carrier Bureau invited public comment on

¹ On January 1, 1992, the former BellSouth operating companies, Southern Bell Telephone and Telegraph Co. and South Central Bell Telephone Co., were merged into BellSouth Telecommunications, Inc.

² BellSouth Telecommunications, Inc., *Order to Show Cause*, 10 FCC Rcd 5037 (1995) (*Order to Show Cause*).

BellSouth's response.³ Only MCI Communications Corporation filed comments, and BellSouth replied on September 11, 1995. The positions of the parties to this consent decree are as follows:

- (a) The Commission found that BellSouth's actions appear to be inconsistent with its statutory obligation to maintain its accounts, records, and memoranda as prescribed by the Commission. Generally, the Commission found that BellSouth had apparently misstated or miscalculated interstate costs and revenues from January 1988 through March 1989. The Commission's specific findings included:
 - (i) The Commission found that BellSouth's calculation of Cash Working Capital apparently violated Commission rules, improperly using average daily cash balances instead of required minimum bank balances.
 - (ii) The Commission found apparent violations of its rules because BellSouth failed to separate correctly its investment in information origination/termination equipment costs in apparent violation of Part 36 of the Commission's rules.⁴
 - (iii) The Commission found a number of other apparent violations of its rules, including BellSouth's failure to provide adequate documentation to support numerous revenue and cost adjustments, and its improper inclusion of presubscription revenues for the predesignation of interexchange carriers in Account 5081, End user revenue. The independent auditor also noted that a BellSouth operating company incorrectly reported an accrual adjustment to NECA resulting in overstatement of common line revenues which would apparently violate Section 69.605 of our rules.⁵
- (b) BellSouth responded to the *Order to Show Cause* contesting liability on all counts, and asserting that no price cap index adjustment was

³ Commission Sets Pleading Schedule In Show Cause Proceedings, *Public Notice*, 10 FCC Rcd 10939 (1995).

⁴ 47 C.F.R. Part 36.

⁵ 47 C.F.R. § 69.605.

appropriate or lawful." BellSouth contests all findings in the Adjustments Report and the Commission's *Order to Show Cause*, on the following grounds:

- (i) Due to its efficient cash management practices, its average daily cash balance was, in fact, the minimum bank balance that BellSouth could maintain and still operate its business. BellSouth also contends that its average daily cash balance represented investor supplied funds that were used and useful in the operation of its business, and that BellSouth was legally entitled to include such amounts in its rate base. BellSouth also argues that it had followed a uniform practice of including its average daily cash balance in its rate base since 1977.⁷
- (ii) BellSouth used direct assignment in good faith and in reliance on the Commission's stated policy of favoring direct assignment whenever possible. BellSouth argues that the information origination/termination equipment in question was directly associated with the provision of special access service, and direct assignment represented a more cost-causative approach than allocation of a portion of these costs to common line.⁸
- (iii) During the transition from Part 67 to Part 36 separations rules, an input error occurred that affected the separations factors for cable and wire facilities in the states of Alabama, Louisiana and Mississippi. As a result, the interstate revenue requirement was overstated by approximately \$1 million and the intrastate revenue requirement was understated by the same amount. BellSouth contends that the impact of the error ceased with the introduction of a new basic factor for these three states on July 1, 1990 and that the error did not affect BellSouth's initial price cap indexes.⁹
- (iv) The independent auditor identified 22 instances in which it

⁷ BellSouth Response to Order to Show Cause, filed herein May 2, 1995. BellSouth Reply Comments, filed herein September 11, 1995.

⁸ BellSouth Response to Order to Show Cause, at 6-16.

⁹ *Id.* at 16-26.

⁹ *Id.* at 26-31

concluded that BellSouth provided inadequate documentation and, based on this, the *Order to Show Cause* tentatively found that BellSouth failed to maintain adequate controls to comply with Part 32. BellSouth states that the independent auditor reviewed over 3,000 adjustments to the common line pool. BellSouth also states that there was no suggestion by the auditor that the entries in question were erroneous; these were documentation issues only and the items cited as documentation errors were extremely minor and in many cases BellSouth has no business reason to maintain formal documentation for the particular types of transactions in question.¹⁰

- (v) A human error occurred in which a \$169,000 accrual adjustment was reported with the wrong sign, resulting in BellSouth overstating common line revenue in September, 1988 by \$338,000. BellSouth therefore under-recovered from the common line pool in this amount. The *Order to Show Cause* cites this error as an example of allegedly deficient internal controls. BellSouth asserts that this was a case of simple human error that did not recur and had no impact on BellSouth's initial price cap indexes.
- (vi) BellSouth states that the rules for the treatment of presubscription revenues for the predesignation of interexchange carriers were never clear. While BellSouth now agrees to accept the interpretation of Ernst and Young that these revenues were more properly associated with switching and therefore should be excluded from common line pool reporting, BellSouth could find no authoritative interpretation from the period under review that specified the proper treatment of these revenues. BellSouth asserts that the rules were ambiguous and that BellSouth made a good faith interpretation of the rules to determine the proper treatment of these revenues. In any event, presubscription revenues are excluded from price caps.¹¹

4. The Commission and BellSouth agree that the expeditious resolution of issues raised by the Adjustments Report and the Commission's *Order to Show Cause* in

¹⁰ *Id.* at 31-39.

¹¹ *Id.*, at 43-47

accordance with the terms of this Consent Decree is in the public interest.

5. Accordingly, and in consideration of the agreement of the Commission and BellSouth to conclude action on the *Order to Show Cause* on the terms set forth in this Consent Decree, BellSouth agrees to act as specified below:

- (a) BellSouth agrees to correct any past accounting and recordkeeping deficiencies that might have caused the apparent violations set forth in paragraph 3 of this Consent Decree;
- (b) BellSouth agrees to establish procedures to prevent the specific apparent deficiencies from recurring in the future;
- (c) BellSouth agrees not to include revenues from customers for the predesignation of their primary interexchange carrier in Account 5081, and shall instead include these revenues in Account 5082, in compliance with the Commission's rules;¹²
- (d) BellSouth agrees to conduct an independent audit of its internal accounting controls as specified in Attachment A of this Consent Decree;

6. In the event BellSouth fails to comply with the requirements set forth in paragraph 5 and Attachment A of this Consent Decree, the Commission reserves the right to pursue legal action against BellSouth. If BellSouth complies with the terms set forth in paragraph 5 and Attachment A of this Consent Decree, then the accounting treatments, procedures and documentation adopted in compliance with paragraph 5 and Attachment A shall be regarded by the Commission as presumptively reasonable and lawful. The Commission, however, reserves its rights under law to change accounting requirements prospectively and retroactively as long as no penalty attaches to such retroactive application. Likewise, BellSouth shall be authorized to make changes to its accounting treatments, procedures and documentation to implement or reflect changes in the law or rules or waivers of the Commission's rules, and shall not thereby be in violation of any part of this Consent Decree.

7. In light of BellSouth's covenants and representations contained in paragraph 5 and Attachment A of this Consent Decree, and in express reliance thereon, the Commission has issued a final order formally authorizing the Secretary to execute this Consent Decree ("Consent Decree Order") without change, addition or modification and

¹² See 47 C.F.R. §§ 32.5081 and 32.5082

without a finding of wrongdoing, violations or liability by BellSouth and further agrees not to begin, on the motion of the Commission or its staff, any proceeding formal or informal, concerning matters that were the subject of the Adjustments Report. Nothing herein, however, shall preclude the Commission from using the information underlying the findings and observations in the Adjustments Report for other lawful regulatory purposes provided that BellSouth shall have all opportunities afforded by law to contest that use and that information

8. BellSouth admits the jurisdiction of the Commission to adopt this Consent Decree.

9. BellSouth waives any rights it may have to judicial review, appeal or rights otherwise to challenge or contest the validity of the Consent Decree Order, provided the Commission adopts this Consent Decree without change, addition or modification.

10. The Parties agree not to engage in conduct inconsistent with the terms of this Consent Decree. The Parties may comment publicly, however, on the nature of the Consent Decree, and the merits of their respective positions, after it has been adopted by the Commission.

11. It is understood that BellSouth's agreement to this Consent Decree does not constitute an adjudication of any factual or legal issues or an admission by BellSouth of wrongdoing, violations or of any inconsistency between its position, on the one hand, and, on the other hand, (i) the Communications Act of 1934, as amended, and (ii) the rules and policies of the Commission. As a result, BellSouth shall not be precluded or estopped from litigating *de novo* any and all of the issues subject to this Consent Decree in any forum, except as provided herein.

12. The Parties agree that this Consent Decree and the Consent Decree Order may not be used in any fashion by either of the Parties to this Consent Decree in any legal proceeding except as set forth in this Consent Decree.

13. Adoption by the Commission of this Consent Decree shall conclude action in the proceeding commenced by the *Order to Show Cause*, 10 FCC Rcd 5637, and the Adjustments Report without a finding of wrongdoing, violations or liability on the part of BellSouth. The Parties agree that the effectiveness of this Consent Decree is expressly contingent upon issuance of the Consent Decree Order described herein, and compliance by BellSouth with the terms of this Consent Decree. If this Consent Decree is not signed by BellSouth and the Commission, or is otherwise rendered invalid by any court of competent jurisdiction, it shall become null and void and may not become part of the record in this proceeding.

14. If the Commission brings an action in any court of competent jurisdiction to enforce the terms of the Consent Decree order or the Consent Decree, BellSouth agrees that it will not contest the validity of either the Consent Decree Order or the Consent Decree, will waive any statutory right to contest the validity of the Consent Decree Order or this Consent Decree through a trial *de novo*, and will consent to a judgment incorporating the terms of this Consent Decree without change, addition or modification provided, however, that the Commission has complied with all of its obligations under the Consent Decree.

15. This agreement may be signed in counterparts.

FEDERAL COMMUNICATIONS COMMISSION

By: William F. Cotten

Acting Secretary

Signed this 21st day of October, 1996

BELLSOUTH TELECOMMUNICATIONS, INC.

By: [Signature]

Its Vice-President, Regulatory (Title)

Signed this 24th day of October, 1996

Attachment A**Independent Review of BellSouth Internal Controls**

BellSouth will engage an independent auditing firm to review the adequacy of internal controls associated with the automated and manual input processes related to the company's Part 36 separations system. The scope of this independent review will be the following three areas:

1. Review of existing internal processes that enable detection and correction of accounting errors on a timely basis;
2. Review of automated systems that have served to eliminate or reduce the potential for clerical errors and that provide an appropriate trail for data verification; and
3. Review of controls and processes for appropriate implementation of the Commission's rules and related interpretations.

The independent review will be completed within one year of the release of the Commission's Consent Decree Order.

Upon completion of the review, BellSouth will submit to the Commission an implementation plan for each recommendation which the independent auditing firm determines has the potential for material impact on the results of the company's cost allocations. All aspects of the implementation plan will be instituted no later than 180 days after the independent review is completed.

Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the matter of

Application by BellSouth Corporation,)
BellSouth Telecommunications, Inc.,)
and BellSouth Long Distance, Inc. for) CC Docket No. 97-231
Provision of In-Region, InterLATA)
Services in Louisiana)

AFFIDAVIT OF

SHARON NORRIS

ON BEHALF OF

AT&T CORP.

AT&T EXHIBIT K

FCC DOCKET NO. 97-231
AFFIDAVIT OF SHARON NORRIS

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the matter of

Application by BellSouth Corporation,)	
BellSouth Telecommunications, Inc.)	
and BellSouth Long Distance, Inc.)	
For Authorization Under Section 271)	CC Docket No. 97-231
Of the Communications Act to Provide)	
In-Region, InterLATA Service)	
In the State of Louisiana)	

**AFFIDAVIT OF
SHARON NORRIS
ON BEHALF OF
AT&T CORP.**

1. My name is Sharon Norris. I am employed by AT&T as a District Manager in the Southern Region Law and Government Affairs organization. Since February, 1997, I have been responsible for monitoring BellSouth's compliance with its legal and contractual obligations to provide AT&T nondiscriminatory access to BellSouth's Operational Support Systems ("OSS").

2. After graduating with honors from DeKalb College in 1972 with a degree in Distributive Education, I began my career with Southern Bell in 1973 in one of its Commercial Business Offices in Atlanta. I held various positions in Southern Bell's business offices, business marketing organization, retail stores, and support staff organizations from 1973 to

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1983. From 1983 to 1985, I provided sales and operational support to AT&T's consumer sales and service organizations (American Bell and AT&T-Information Systems). In 1985, I transferred to AT&T-Information Systems' Human Resources organization, where I held various positions until 1991. In 1991, I transferred to the AT&T Law and Government Affairs organization. My initial assignment was to serve as loaned executive to the Governor's Efficiency Commission for the State of Georgia. In 1995, I assumed responsibility as AT&T's representative before the Georgia Public Service Commission. In 1997, I assumed my current position.

I. PURPOSE AND SUMMARY OF AFFIDAVIT

3. The purpose of my affidavit is to address the reliance the Louisiana Public Service Commission ("LPSC") places on a four hour "technical conference" to support its conclusion that BellSouth provides AT&T and other competitive local exchange carriers ("CLECs") with nondiscriminatory electronic access to BellSouth's OSS.¹ This Commission has repeatedly made clear that "nondiscriminatory access" means that the access provided to CLECs must be "the same" as or "equal to" the access that BellSouth provides to its own customer representatives.² The Commission characterizes this requirement as a "fundamental

¹ The OSS issue is covered comprehensively and in detail in the affidavit of Jay Bradbury being filed along with my affidavit.

² See, e.g., First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98 (released August 8, 1996), ¶ 523 ("the incumbent must provide the same access to competing providers" that it provides to its own customer service representatives); Second Order on Reconsideration in CC Docket No. 96-98, released December 13, 1996, ¶ 9 (OSS access must be "at least equivalent" or "equal

(continued...)

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obligation" of a BOC. Ameritech Michigan Order, ¶ 128. Despite the critical nature of the OSS issue, the LPSC's resolution of the OSS issue is contained in a single, three-sentence paragraph, in which the LPSC, citing the technical conference it conducted on August 13, 1997, concludes that BellSouth's OSS "allows potential competitors full non-discriminatory access to the BellSouth system."³ The LPSC's order does not mention, much less address:

- the voluminous evidence provided by CLECs, and even by BellSouth itself, demonstrating that BellSouth is not currently providing nondiscriminatory access to its OSS;
- the recommendation of the LPSC's chief administrative law judge ("Chief ALJ"), who initially heard, reviewed and analyzed that evidence and, following seven days of hearings, found for reasons set out in detail in a written recommendation that "BellSouth has not demonstrated to the Commission that

² (...continued)

to" the access that the incumbent LEC provides to itself); CC Docket No. 97-137, In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan, Memorandum Opinion and Order released August 19, 1997 ("Ameritech Michigan Order"), ¶ 143 ("We require, simply, that the BOC provide the same access to competing carriers that it provides to itself").

³ See Docket U-22252, Consideration and Review of BellSouth Telecommunications, Inc.'s Preapplication Compliance with Section 271 of the Telecommunications Act of 1996, Order U-22252-A dated September 5, 1997 ("LPSC Compliance Order"), p. 15.

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its operational support systems, as provided for in its SGAT, can actually provide, at this time, nondiscriminatory access to new entrants;"⁴ and -- the recommendation of the LPSC Staff concurring in the Chief ALJ's findings and conclusions with regard to OSS.⁵

Because no transcript of the technical conference has been made and the LPSC Compliance Order contains no description of what happened at the conference -- much less any explanation of how the conference persuaded the LPSC to ignore the recommendations of its Chief ALJ and Staff -- my affidavit will describe the presentations made at the conference. As set forth below, the technical conference (which did not include any information concerning the internal systems that BellSouth, as an incumbent LEC, provides to itself) did not even remotely demonstrate the absence of the deficiencies identified by the Chief ALJ. To the contrary, the technical conference provided fresh demonstrative evidence that BellSouth currently fails to provide nondiscriminatory access to its OSS.

4. The remainder of my affidavit is organized as follows. Section II describes the hearing conducted by the Chief ALJ and the Chief ALJ's recommendation based on that hearing. Section III describes the August 13 technical conference. Finally, Section IV describes the LPSC's resolution of the OSS issues in the LPSC Compliance Order.

⁴ Docket U-22252, Consideration and Review of BellSouth Telecommunications, Inc.'s Preapplication Compliance with Section 271 of the Telecommunications Act of 1996, ALJ Recommendation dated August 14, 1997 ("ALJ Recommendation"), p. 30.

⁵ Docket U-22252, Consideration and Review of BellSouth Telecommunications, Inc.'s Preapplication Compliance with Section 271 of the Telecommunications Act of 1996, LPSC Staff 271 Recommendation dated August 15, 1997 ("LPSC Staff Recommendation"), p. 3.

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II. THE PROCEEDINGS BEFORE THE CHIEF ALJ

5. By Notice issued March 3, 1997, the LPSC assigned review of BellSouth's compliance with Section 271 to the LPSC's Chief ALJ, Valerie Seal Meiners. The parties before the Chief ALJ filed written direct and rebuttal testimony of sixteen different witnesses. The Chief ALJ presided over seven days of hearings, in May 1997, during which these witnesses were cross-examined by the parties, as well as by the LPSC Staff and the Chief ALJ herself. The LPSC Commissioners did not participate in the hearings.

6. On August 14, 1997, the Chief ALJ issued her recommendation with respect to BellSouth's compliance with Section 271 and the lawfulness of BellSouth's SGAT under Section 252(f) of the Telecommunications Act of 1996.⁶ Based on the hearings over which she had presided, the Chief ALJ concluded that BellSouth had failed to demonstrate that it is currently providing nondiscriminatory access to its OSS:

BellSouth has not demonstrated to the Commission that its operational support systems, as provided for in its SGAT, can actually provide, at this time, nondiscriminatory access to new entrants. There is no evidence in the record that BellSouth's interfaces can perform as well as BellSouth claims they will and no evidence that access is nondiscriminatory from the standpoint of the amount of time necessary to access the OSS and obtain the desired information or services. Further, BellSouth has not demonstrated that its OSS provides information on an equal, nondiscriminatory basis, or that its interfaces are equally user-friendly to both BellSouth and its competitors.

⁶ BellSouth filed its SGAT on May 19, 1997, the first day of the hearings before the Chief ALJ, and the scope of the proceeding was then expanded to consider the lawfulness of the SGAT. On July 9, 1997, the Chief ALJ issued a recommendation that the LPSC reject the SGAT, because the LPSC had not completed its dockets instituted for determining whether the rates for interconnection and unbundled elements contained in the SGAT were lawful. By order issued on July 28, 1997, the LPSC remanded the proceeding to the Chief ALJ for recommendations concerning BellSouth's compliance with those elements of the 14-point checklist beyond the pricing issue previously addressed by the Chief ALJ.